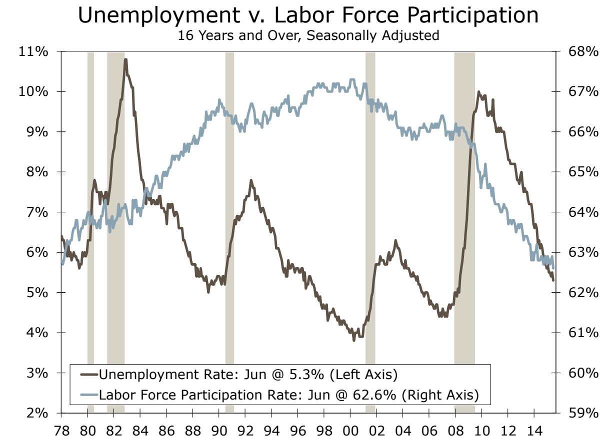
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Sparklers, not Fireworks, in June Jobs Report

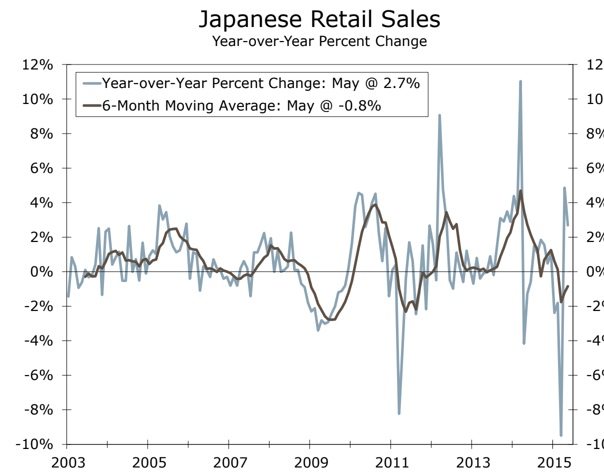
- Employers added 223,000 new jobs in June, while the unemployment rate fell to 5.3 percent. Although nearly within striking distance of the Fed's range for full employment, June's decline was largely driven by another drop in the participation rate.
- Consumer confidence jumped 6.8 points in June on the back of better assessments of the labor market and business conditions.
- The ISM manufacturing index rose for the third straight month. However, at 53.6, the index indicates that growth in the factory sector remains modest.



Global Review

Mixed but Mostly Positive Week in Japan

- There were some conflicting indicators this week about the health of the struggling Japanese economy. Retail sales figures surprised on the upside, lifting prospects for second quarter consumer spending.
- Industrial production slowed sharply in May but another key measure of manufacturing activity increased for the second quarter. On balance, these mixed messages viewed in the context of last week's CPI report indicate that BoJ policymakers have little reason to change the pace of the current expansion of the monetary base in Japan.



Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual			Forecast	
	2014				2015				2012	2013	2014	2015	2016
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product [1]	-2.1	4.6	5.0	2.2	-0.2	2.0	2.8	3.6	2.3	2.2	2.4	2.2	2.9
Personal Consumption	1.2	2.5	3.2	4.4	2.1	3.3	2.8	3.0	1.8	2.4	2.5	3.1	2.8
Inflation Indicators [2]													
PCE Deflator	1.1	1.6	1.5	1.1	0.3	0.2	0.4	1.0	1.8	1.2	1.3	0.5	2.0
Consumer Price Index	1.4	2.1	1.8	1.2	-0.1	0.0	0.3	1.0	2.1	1.5	1.6	0.3	2.2
Industrial Production [1]	3.9	5.7	4.1	4.7	-0.3	-2.1	2.5	3.1	3.8	2.9	4.2	1.7	3.0
Corporate Profits Before Taxes [2]	-4.8	0.1	1.4	-0.2	4.5	3.2	3.9	4.8	11.4	4.2	-0.8	4.1	5.3
Trade Weighted Dollar Index [3]	76.9	75.9	81.3	85.1	92.1	90.5	91.5	92.8	73.5	75.9	78.5	91.7	95.9
Unemployment Rate	6.6	6.2	6.1	5.7	5.6	5.4	5.3	5.2	8.1	7.4	6.2	5.4	5.0
Housing Starts [4]	0.93	0.98	1.03	1.06	0.98	1.14	1.23	1.25	0.78	0.92	1.00	1.15	1.25
Quarter-End Interest Rates [5]													
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	0.25	0.25	0.25	0.44	1.56
Conventional Mortgage Rate	4.34	4.16	4.16	3.86	3.77	4.05	4.15	4.23	3.66	3.98	4.17	4.05	4.51
10 Year Note	2.73	2.53	2.52	2.17	1.94	2.25	2.35	2.41	1.80	2.35	2.54	2.24	2.66

Forecast as of: June 26, 2015
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change
[3] Federal Reserve Major Currency Index, 1973=100 - Quarter End
[4] Millions of Units
[5] Annual Numbers Represent Averages

Source: U.S. Department of Commerce, U.S. Department of Labor, Federal Reserve Board, IHS Global Insight and Wells Fargo Securities, LLC

Inside

U.S. Review

Sparklers, not Fireworks, in June Jobs Report

The labor market made further strides in June, with employers adding 223,000 jobs over the month and the unemployment rate fell to a new cycle low of 5.3 percent. While job gains were nearly in line with expectations and still indicate a strong pace of hiring, details were somewhat disappointing. First, job growth in April and May was revised lower by a total of 60,000 jobs. Second, the decline in the unemployment rate came amid a sizeable drop in the labor force, which brought the labor force participation rate down 0.3 percentage points to a new cycle low of 62.6 percent. The participation rate had shown nascent signs of stabilizing over the past year, making it unclear whether June's drop is part of normal volatility in the household survey, or the continuation of the downward trend that has dominated over the course of the expansion.

Hopes for further signs of a clear turnaround in wage growth were dashed in today's report; average hourly earnings were flat in June and May's increase was revised down by one-tenth. Average hourly earnings are now up just 2.0 percent over the past year, consistent with the general pace of growth seen over the expansion.

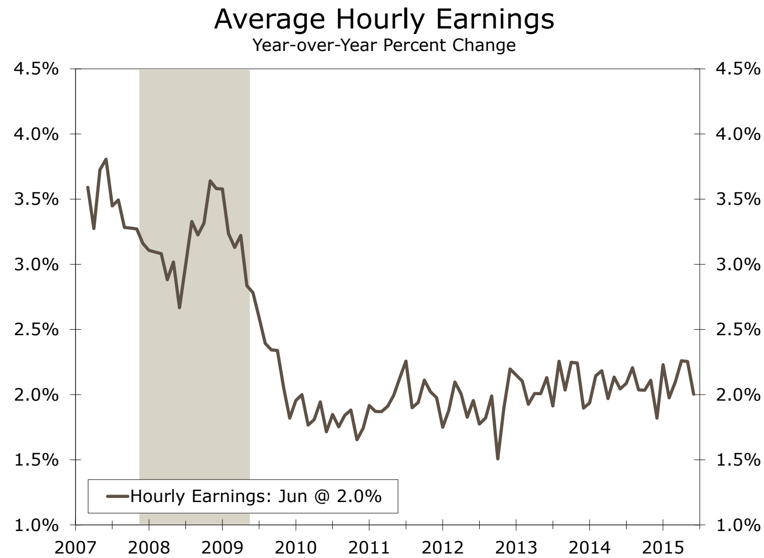
Consumer Confidence Looking Up

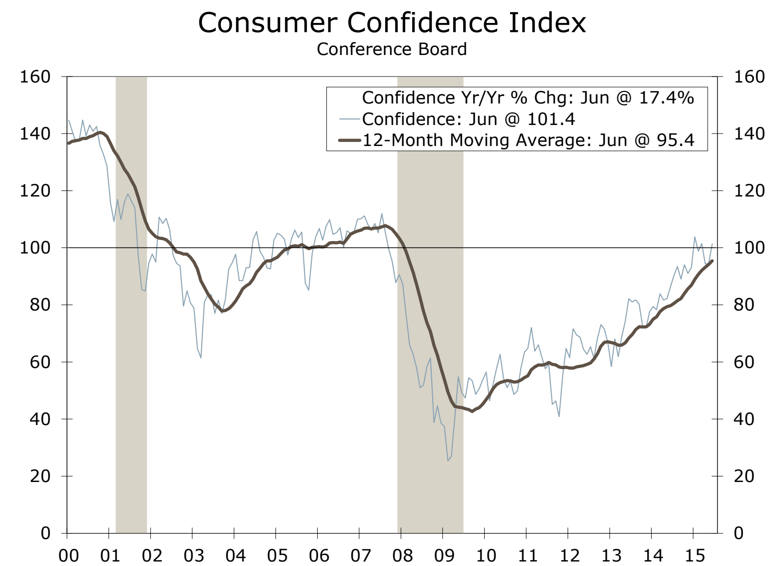
The further strengthening in the labor market has likely been a big factor in boosting consumer confidence. The Conference Board's measure of consumer confidence jumped 6.8 points in June and is now back above 100. Views of the labor market improved, with the labor differential—the share of respondents reporting jobs are plentiful minus the share reporting jobs are hard to get—rising to its second-highest mark of the expansion. The pickup in confidence also comes as gasoline prices have risen more than usual this time of year. Typically, this would be associated with deterioration in confidence, but consumers may be beginning to feel like the plunge in gas prices over the past year is not going to be reversed anytime soon.

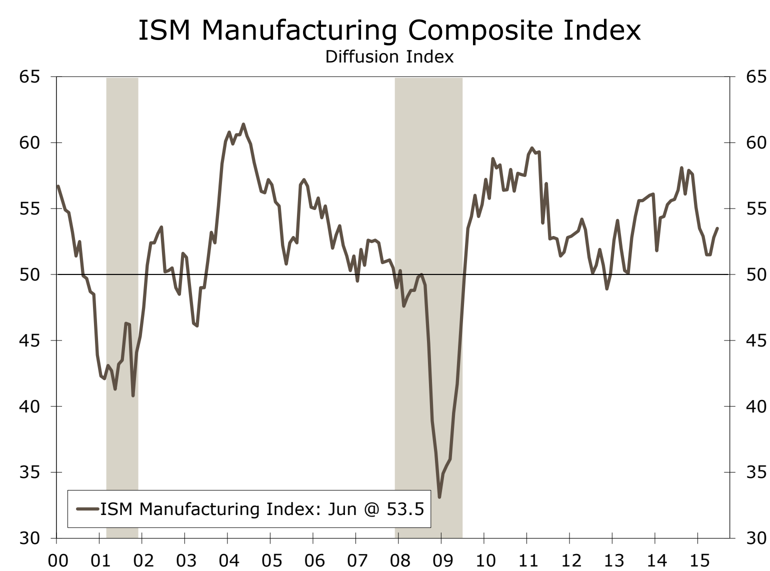
Plans to purchase a home in the next six months remained steady at 5.9 percent, the second-highest reading since 2014. It is a little too early to tell whether the recent backup in mortgage rates is affecting activity in the housing market. Mortgage applications for purchase fell 4.1 percent this week, but are at the highest level in nearly two years on a four-week moving average basis. Pending home sales have also continued to grind higher, rising 0.9 percent in May and 8.3 percent over the past year.

Manufacturing Activity on the Rebound

Elsewhere, data on the manufacturing sector showed the worst of the industry's recent soft patch may be behind us. The ISM manufacturing index edged up 0.7 points in June. That puts the index back at January's level, before the West Coast Port issues came to a head and when the dollar was still rapidly rising. Although durable goods orders have yet to show as convincing of a turnaround, the rise in the ISM new orders index to a six-month high provides further evidence that the weakness in the factory sector is fading.







Source: U.S. Dept. of Labor, The Conference Board, Institute for Supply Management and Wells Fargo Securities, LLC

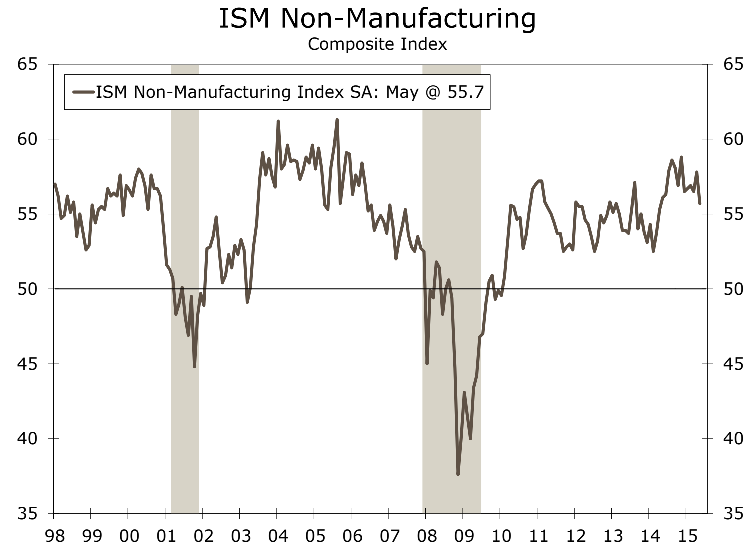
ISM Non-Manufacturing • Monday

We have seen the ISM non-manufacturing index moderate since the index peaked late last year, although it still remains firmly in expansion territory. In May, the ISM non-manufacturing index gave back all of April's gains as the index slipped to 55.7, indicating that activity outside the manufacturing sector increased at a more moderate pace in the month. Growth slowed in current activity and new orders, although these components are still at relatively healthy levels. Backlog of orders was the only component to contract on the month. In addition, the prices paid component jumped 5.8 points to 55.9, indicating that inflation pressures are firming.

We suspect the index rose modestly in June to 55.9. We learned this morning that payrolls posted another strong gain. This points to continued expansion in the non-manufacturing sector.

Previous: 55.7 **Wells Fargo: 55.9**

Consensus: 56.4



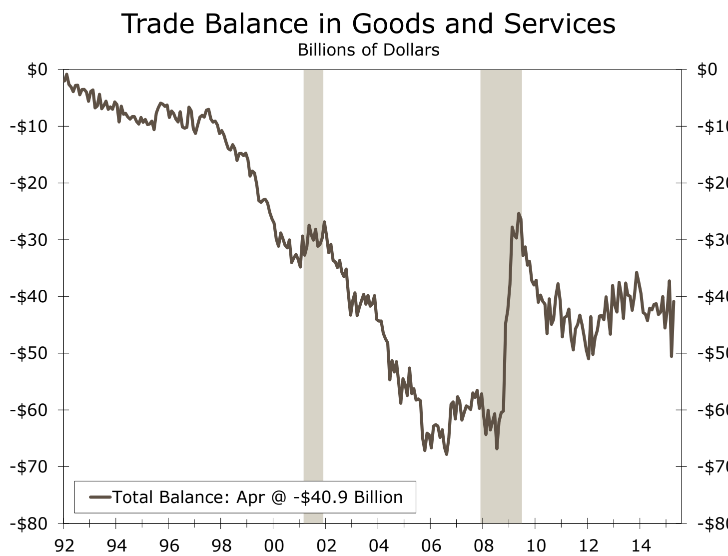
International Trade • Tuesday

The trade balance has been notoriously volatile to begin the year. West Coast port disruptions because of labor disputes have been the culprit behind this volatility. Non-petroleum imports declined sharply over the first two months of the year before surging in March once the port disruptions were resolved. The April decline brought imports back in line with the rate seen before the port disruptions. Exports, on the other hand, were not as severely affected by the port disruptions.

Net exports subtracted 1.9 percentage points off of first-quarter GDP growth. While we expect net exports to have a less pronounced impact on topline GDP during the second quarter, it should still be a slight negative. We forecast that the trade balance continued to narrow in May to -$41.6 billion.

Previous: -$40.9B **Wells Fargo: -$41.6B**

Consensus: -$43.0B



JOLTS • Tuesday

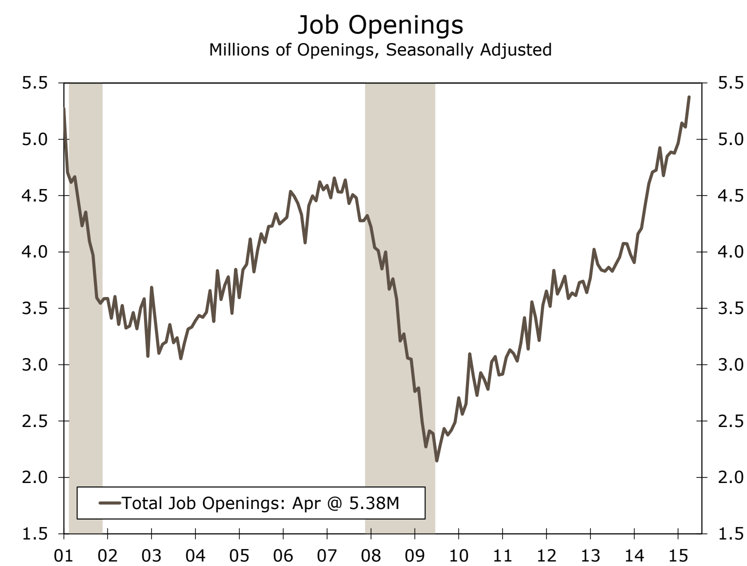
In April, job openings climbed to a record high of 5.4 million. Job openings have increased rapidly throughout 2015. Hiring has not seen the same improvement in 2015 and has moderated slightly to start the year, another sign that labor market turnover is relatively low.

Separations fell in April, although the trend in separations tends to be encouraging. The majority in the increase in separations seen recently has come from quits rather than layoffs. A higher quits rate likely indicates people are more confident in their prospects for finding a new job.

On balance the labor market continues to improve. Nonfarm payrolls increased a revised 254,000 in May and 223,000 in June. In addition, the unemployment rate ticked down to 5.3 percent.

Previous: 5.38M

Consensus: 5.30M



Source: Institute for Supply Management, U.S. Dept. of Commerce, U.S. Dept. of Labor and Wells Fargo Securities, LLC

Global Review

Pickup in Japan's Retail Sales

We have made the case previously that despite Japan's many economic challenges, there was room for growth in consumer spending. A big reason why consumer spending has been so weak is that, despite nominal wage increases, real wages have been under pressure. As we passed the anniversary of the April 2014 consumption tax increase, CPI inflation has slowed with a corresponding boost to real wage growth.

May retail sales figures topped consensus expectations. The 1.7 percent monthly gain was the largest sequential monthly increase in nine months. While it is too soon to bank on a rejuvenated Japanese consumer, it is an indication that second quarter GDP growth should get some help from consumer spending. Gains in May retail sales were broadly based with increases at discount retailers and even larger gains in department stores.

Conflicting Reads on Japanese Factory Sector

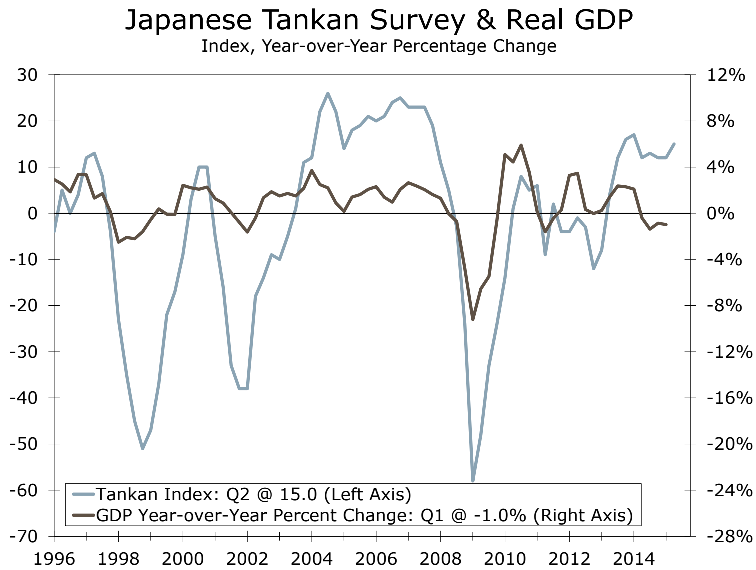
A key measure of output for the Japanese economy also hit the wire this week and was decidedly negative for the outlook for Japanese manufacturing. Industrial production tumbled 2.2 percent in May and is now off 4.0 percent on a year-over-year basis. Inventories, which have increased every month so far this year, climbed another 0.9 percent in May.

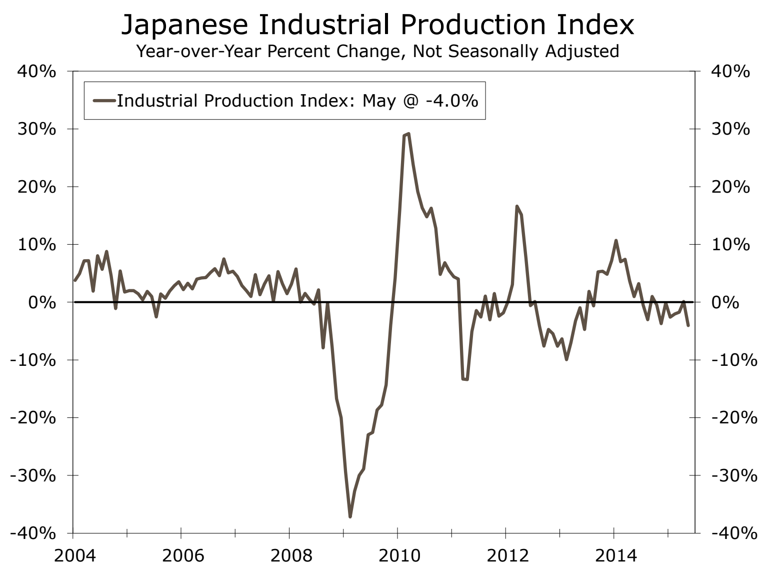
The vital auto sector is under pressure in Japan with vehicle production down 16.6 percent from a year ago. That is the largest annual decline in auto assemblies since 2012. The disappointing output figures are offset by improving auto sales which increased 5.4 percent in June on a year-over-year basis.

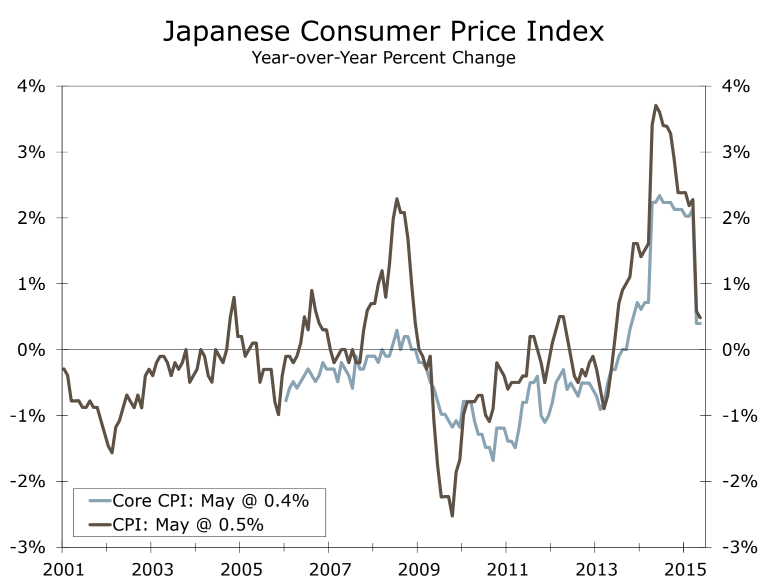
Tempering the concerns about the outlook for manufacturing, we also learned this week that the Tankan Large Manufacturing Index—a key yardstick for activity in the Japanese factory sector—climbed to a reading of 15 in June. The highest reading since the global recession was 17, so the current measure suggests a much better situation than the "hard data" industrial production figures. Similarly the service sector measure from the Tankan report also rose to 23, not far from the cycle high of 24.

Both measures were better than consensus expectations and suggest that the business sector in Japan is encouraged by the measures taken by the Bank of Japan (BoJ) to spur economic growth and CPI inflation.

Last week, we learned that CPI inflation in Japan came in a shade stronger than expected at 0.5 percent vs. expectations for 0.4 percent. These were May figures, so they reflect the second month after the effects of last year's consumption tax which boosted prices. Both headline and core inflation are rather weak at present. We suspect that prices will climb gradually this year as we begin to emerge from the shadow of the tax hike, but inflation will remain well below the BoJ's stated target of 2.0 percent over time. Given the offsetting nature of this week's data, there is little to push BoJ to change the present pace of monetary base expansion.







Source: IHS Global Insight and Wells Fargo Securities, LLC

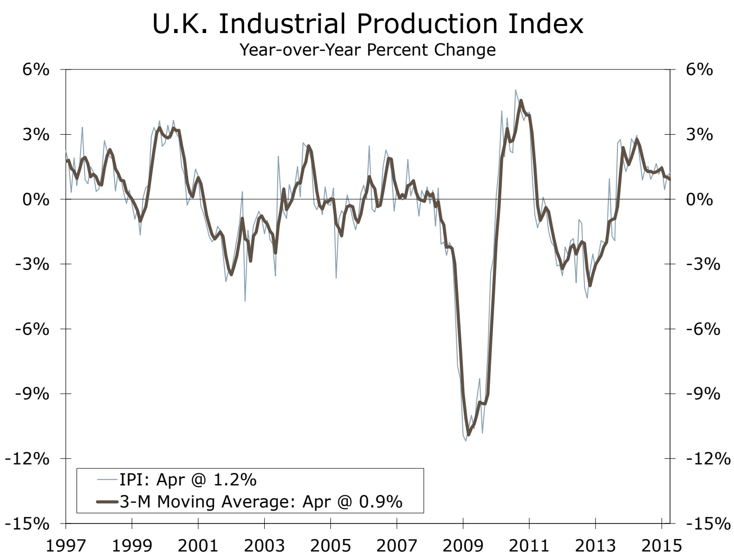
German Factory Orders • Monday

The German economy has taken a back seat lately in terms of Eurozone economic activity, allowing France's economy to leap forward and contribute more to the region's recovery. On Monday, we will get the release of factory orders for May followed by industrial production on Tuesday. Factory orders have grown by more than 1 percent for two consecutive months, which makes another positive reading in May difficult to achieve.

After a very strong reading in German industrial production in April, 0.9 percent, the consensus is also looking for another positive reading in May, this time a 0.1 percent increase. This improvement in industrial production follows a weak reading for the manufacturing PMI in May, coming at 51.1.

Previous: 1.4% (Month-over-Month)

Consensus: -0.1%



U.K. Industrial Production • Tuesday

After a relatively weak end to last year and first months of this year the U.K.'s industrial production index has recovered handsomely, printing a 0.6 percent rate in March and a 0.4 percent rate in April. If the May release on Tuesday comes in positive it would be the fourth consecutive positive reading for the index and a good omen for the performance of the U.K. economy in the second quarter.

Perhaps the biggest doubt for next week's release is the fate of the manufacturing sector, which disappointed in April by dropping 0.4 percent after a similar increase in March. If the PMI manufacturing index for May is any indication then markets should not be overly optimistic with U.K. manufacturing sector. However, due to the drop in April, markets are expecting a bounce back in May of 0.2 percent.

Previous: -0.4% (Month-over-Month)

Consensus: 0.4%

Mexico Industrial Production • Friday

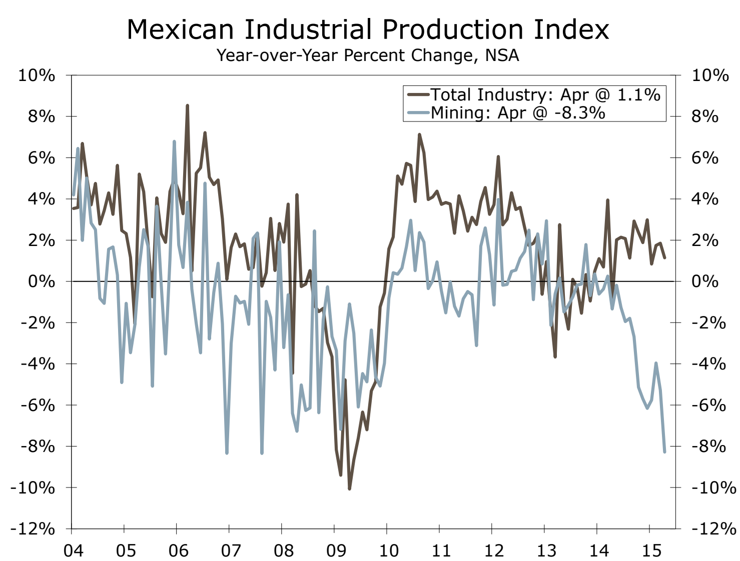
Mexican industrial production has been disappointing, month-in-month-out during this year as the country's mining, which includes the country's petroleum and natural gas sector, has continued its downward spiral. The year-over-year industrial production index was down to only 1.10 percent in April from a 1.85 percent reading in March.

However, buried within the index has been a much better manufacturing sector, which, with its all-important automobile manufacturing industry, has continued to save the day, posting year-over-year rates of growth in excess of 3.0 percent since February of this year.

We expect a similar picture for May's readings in industrial and manufacturing production next week as the automobile sector in Mexico continues to be supported by a very strong U.S. consumer.

Previous: 1.1% (Year-over-Year)

Consensus: 0.6%



Source: Bloomberg LP, IHS Global Insight and Wells Fargo Securities, LLC

Interest Rate Watch

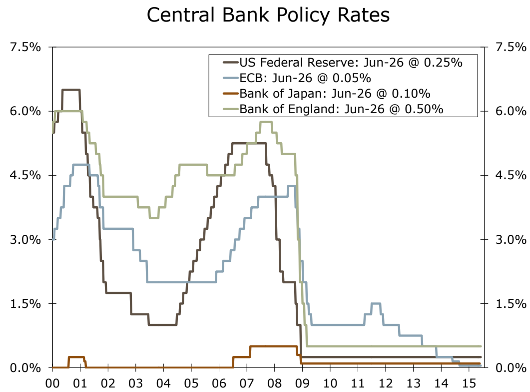
Will Greece Influence the Fed?

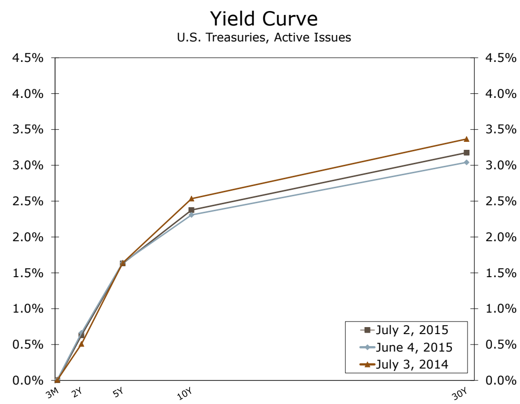
The Federal Reserve certainly has numerous things to consider as it prepares for this month's events. Janet Yellen journeys to Capitol Hill on July 15 to deliver her semi-annual testimony to Congress in which the Fed Chair may give some hints about Fed policy going forward. The Federal Open Market Committee (FOMC), the Fed's policymaking body, plans to hold a regularly scheduled policy meeting on July 29.

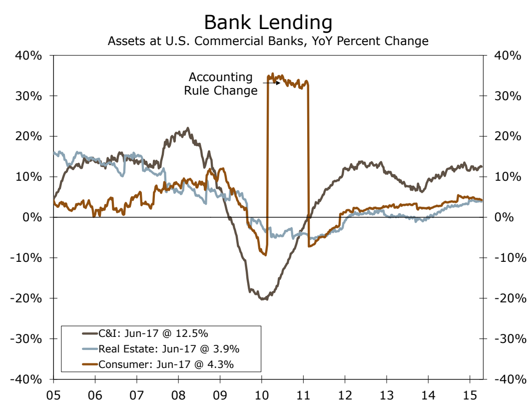
On one hand, there is the evidence, which includes today's news that non-farm payrolls rose by 223,000 in July, that the American economy is currently expanding at a solid pace. On the other hand, however, there is the potential instability that a Greek exit from the Eurozone, should it occur, could impart on financial markets and potentially on global growth (see the Topic of the Week on page 7).

Yellen's testimony to Congress likely isn't written yet, and the FOMC does not need to make a decision until July 29. Therefore, Fed policymakers have the luxury of waiting and watching developments before making any policy decisions. Regardless of what happens to Greece over the next few weeks, the FOMC likely won't hike rates at the July 29 policy meeting. Fed officials simply have not communicated to markets that a rate hike is imminent. Yellen clearly could drop a strong hint about an imminent rate hike during her Congressional testimony. However, the absence of a scheduled press conference following the July 29 FOMC meeting makes a rate hike at that meeting unlikely. For something as important as the first Fed rate hike in nine years, the FOMC likely would want to clearly communicate its reasons for doing so.

In our view, the Fed will not opt to keep rates on hold simply to "help out" Greece. Greece will affect the Fed's thinking only to the extent that it has an effect on U.S. financial markets and, more broadly, the outlook for the U.S. economy. Therefore, Fed officials can continue to wait and watch the incoming data to determine when to begin the rate-hiking process.







Source: IHS Global Insight, Bloomberg LP and Wells Fargo Securities, LLC

Credit Market Insights

Credit Markets Teeter

The recently released Credit Managers' Index (CMI) pointed to continued weakness in June, according to the National Association of Credit Management. The index is a monthly compilation of surveys from U.S. credit and collections professionals in the service and manufacturing industries. June's reading came in at 53.4 from 54.1 the month prior. Year over year, the combined index is down 4.8 percent. This modest change reflects a similar slide seen earlier this year when March came in at 53.4 from a 54.1 reading in February.

The brunt of the pullback came predominantly from the unfavorable factors, which slipped into contraction territory—the first time in three years (below the 50 mark)—and includes factors such as accounts placed in collections, rejections of credit applications and filings for bankruptcies. Not to say that this pattern will continue the rest of the year but currently, a number of companies are not where they want to be financially and some are falling behind on their obligations.

The decline was broadly-based with the manufacturing sector's decrease being attributed to a dip in creditworthiness in the new applicant pools and an increase in unfavorable factors. The service sector's decline was credited to an increase in accounts going to collections; however, we should see this area improve as retail continues to recover.

Credit Market Data

Mortgage Rates	Current	Week Ago	4 Weeks Ago	Year Ago
30-Yr Fixed	4.08%	4.02%	4.04%	4.12%
15-Yr Fixed	3.24%	3.21%	3.25%	3.22%
5/1 ARM	2.99%	2.98%	3.01%	2.98%
1-Yr ARM	2.52%	2.50%	2.53%	2.38%

Bank Lending	Current Assets (Billions)	1-Week Change (SAAR)	4-Week Change (SAAR)	Year-Ago Change
Commercial & Industrial	$1,885.8	2.14%	10.62%	12.49%
Revolving Home Equity	$448.7	-7.53%	-6.35%	-3.63%
Residential Mortgages	$1,609.1	18.41%	2.50%	1.59%
Commerical Real Estate	$1,682.1	17.27%	9.88%	8.47%
Consumer	$1,220.3	0.51%	3.75%	4.26%

Source: Freddie Mac, Federal Reserve Board and Wells Fargo Securities, LLC

Topic of the Week

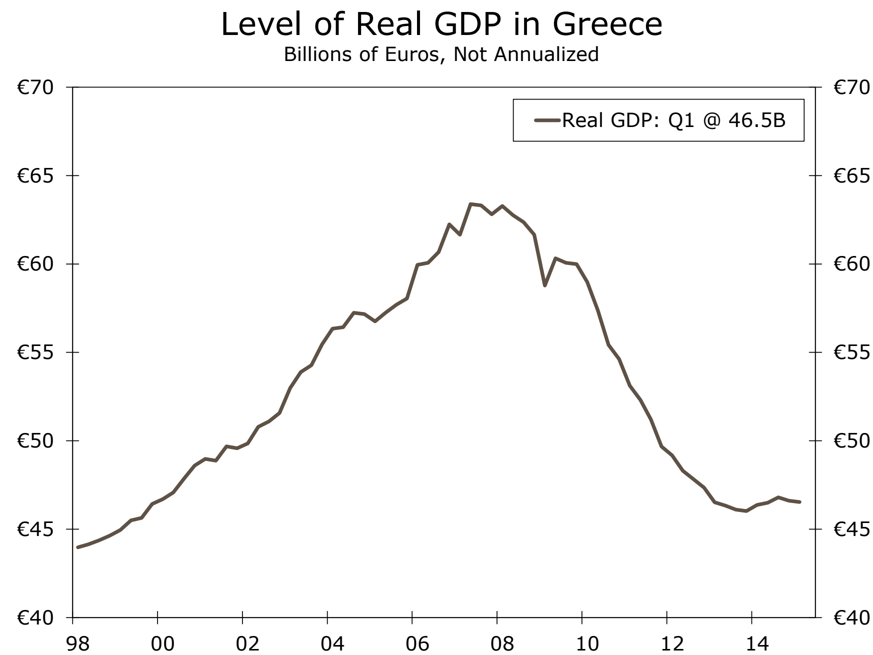
Greek Referendum to Decide Country's Fate

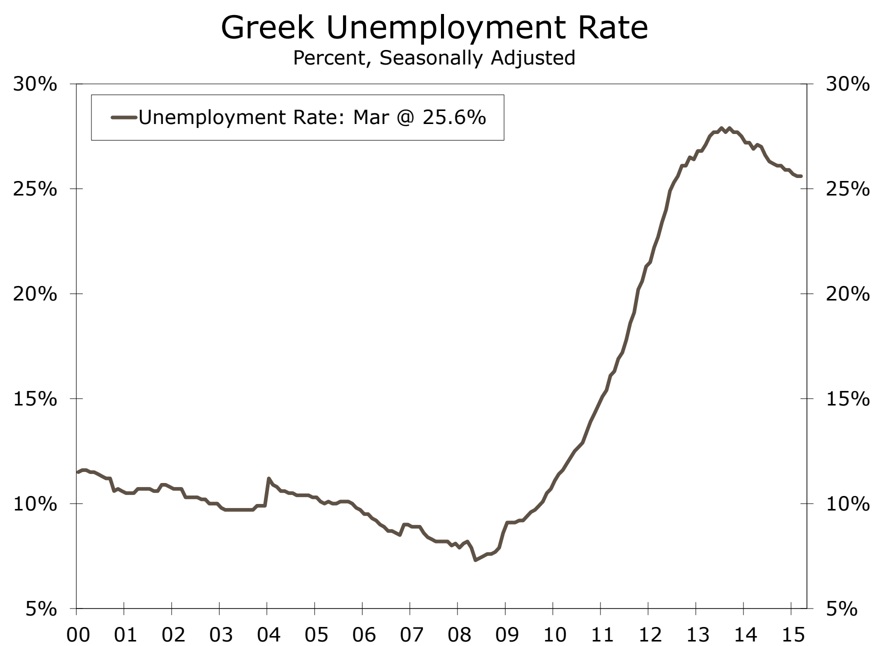
Much has changed since we wrote about Greece in this space only a week ago. Specifically, Prime Minister Alexis Tsipras surprised everyone last Friday night when he called for a referendum to be held on Sunday July 5 on the question of whether the country should agree to creditors' demand of more austerity. Although a last-minute deal between the Greek government and its creditors may yet be reached, it seems likely that the referendum will go ahead as scheduled on Sunday.

If voters say "yes," then they are agreeing to accept more austerity in return for more money from the country's creditors. In that event, the current Greek government likely would resign and a new coalition government would finish the negotiations. As we implied last week, we think it is likely that the institutions (e.g., the IMF, the ECB, etc.) that hold the majority of Greece's debt will eventually be forced to write off a significant part of this debt. An agreement, however, would "kick the can down the road" for another year or two.

If voters say "no" to more austerity, then creditors likely will not cough up more money and Greece probably would need to leave the Eurozone. Voting to essentially exit the Eurozone, which could have numerous negative consequences, may not seem rational to many observers. However, some Greek citizen may question "how much worse could it be?" The Greek economy contracted 27 percent between 2007 and 2013 (top chart) and recovery remains elusive. The unemployment rate stands in excess of 25 percent (bottom chart). In the eyes of some Greek citizens, the past five years of austerity do not appear to have put the economy on a path toward recovery.

The outcome of the referendum remains very uncertain. Regardless of what the voters decide, we remain of the opinion that Greece will remain "an issue" for some time (as we indicated last week).





Source: IHS Global Insight, Wells Fargo Securities, LLC

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Market Data ♦ Mid-Day Thursday

U.S. Interest Rates	Thursday 7/2/2015	1 Week Ago	1 Year Ago
3-Month T-Bill	0.00	0.00	0.02
3-Month LIBOR	0.28	0.28	0.23
1-Year Treasury	0.28	0.29	0.16
2-Year Treasury	0.63	0.69	0.48
5-Year Treasury	1.63	1.71	1.71
10-Year Treasury	2.38	2.41	2.63
30-Year Treasury	3.18	3.18	3.46
Bond Buyer Index	3.80	3.79	4.29

Foreign Exchange Rates	Thursday 7/2/2015	1 Week Ago	1 Year Ago
Euro ($/€)	1.109	1.121	1.366
British Pound ($/£)	1.561	1.575	1.717
British Pound (£/€)	0.710	0.711	0.796
Japanese Yen (¥/$)	123.080	123.630	101.770
Canadian Dollar (C$/$)	1.256	1.233	1.066
Swiss Franc (CHF/$)	0.944	0.937	0.889
Australian Dollar (US$/A$)	0.763	0.774	0.944
Mexican Peso (MXN/$)	15.692	15.481	12.997
Chinese Yuan (CNY/$)	6.205	6.209	6.210
Indian Rupee (INR/$)	63.513	63.625	59.694
Brazilian Real (BRL/$)	3.099	3.128	2.224
U.S. Dollar Index	96.142	95.187	79.956

Foreign Interest Rates	Thursday 7/2/2015	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.01	-0.02	0.18
3-Month Sterling LIBOR	0.58	0.57	0.55
3-Month Canada Banker's Acceptance	0.99	1.00	1.27
3-Month Yen LIBOR	0.10	0.10	0.13
2-Year German	-0.25	-0.20	0.03
2-Year U.K.	0.60	0.68	0.93
2-Year Canadian	0.47	0.62	1.13
2-Year Japanese	0.02	0.01	0.07
10-Year German	0.85	0.86	1.29
10-Year U.K.	2.08	2.14	2.75
10-Year Canadian	1.72	1.81	2.32
10-Year Japanese	0.53	0.48	0.56

Commodity Prices	Thursday 7/2/2015	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	57.27	59.70	104.48
Gold ($/Ounce)	1164.88	1173.25	1326.86
Hot-Rolled Steel ($/S.Ton)	475.00	478.00	660.00
Copper (¢/Pound)	263.40	262.30	325.25
Soybeans ($/Bushel)	10.39	9.78	13.88
Natural Gas ($/MMBTU)	2.84	2.85	4.36
Nickel ($/Metric Ton)	11,982	12,726	19,042
CRB Spot Inds.	462.00	466.82	532.45

Source: Bloomberg LP and Wells Fargo Securities, LLC

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	6	7	8	9	10
U.S. Data	**ISM Non-Manufacturing** May 55.7 June 55.9 (W)	**Trade Balance** April -$40.9B May -$41.6B (W) **JOLTS** April 5376 May			
Global Data	**Germany** **Factory Orders (MoM)** Previous (April) 1.4%	**United Kingdom** **Industrial Production (MoM)** Previous (April) 0.4%	**Australia** **Unemployment Rate** Previous (May) 6.0% **China** **CPI (YoY)** Previous (May) 1.2%	**Japan** **PPI (YoY)** Previous (May) -2.1%	**Mexico** **Industrial Production (YoY)** Previous (April) 1.1% **Canada** **Unemployment Rate** Previous (May) 6.8%

Note: (W) = Wells Fargo Estimate (C) = Consensus Estimate

Source: Bloomberg LP and Wells Fargo Securities, LLC

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